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SUBJECT: THE SIGNIFICANCE OF IRAQ'S OIL BID ROUNDS

REF: BAGHDAD 3196

Classified By: Ambassador Christopher Hill for reasons 1.5 b,d

11. (SBU) Summary: The GOI's June and December oil bid rounds) history's largest (by reserves)) have the potential to significantly alter Iraqi economics and politics. While much can easily go astray (on contracts, timetables, onshore construction, or export infrastructure), Iraq could conceivably be the world's largest exporter of oil within ten years. The impact should be largely positive, and U.S. firms will participate in nearly one third of Iraq's new, future oil production. If oil sector investors are successful in their projects, the resulting revenue growth will spur broad economic growth and investment in non-oil sectors. Failure to equitably share the benefits from oil, however, could exacerbate internal regional tensions, especially among the Sunni community, and further complicate Arab-Kurd tensions. (Septels will examine challenges to attaining Iraq's ambitious production targets, the potential effect on Iraq's investment climate, impacts on domestic and sectarian politics, implications for relations with OPEC, and impacts on U.S. firms.) End summary.

12. (U) Transparency and Diversity: As described in detail reftel, the oil round bid process was a model of transparency. All regulations and model contracts were published in advance, and bidding was conducted live, before an audience including the media, with much of it broadcast live on Iraqi television. Participation in the bid rounds and in the final awards was diverse, with no nation or company dominating the results. For example, in the second bid round, the Ministry of Oil (MOO) invited 44 companies from 23 countries to bid. Of those, some 21 companies from 17 countries actually bid. Taken together, in the two rounds, 15 companies from 13 countries were awarded contracts, including representatives of all five United Nations P-5 countries: ExxonMobil and Occidental (U.S.); BP and Shell (UK); Lukoil and Gazprom (Russia), Total (France); and CNPC (PRC). Other countries represented included the Netherlands, Malaysia, Korea, Italy, Japan, Norway, Turkey, and Angola. Chinese company Sinopec was barred from the round for its bilateral business deals (considered illegal by the GOI) with the Kurdistan Regional Government.

13. (U) U.S. companies: No U.S. firm won a contract in the second bid round, but as winners of two fields from the first bid round, ExxonMobil and Occidental will participate in the development of approximately one-third of Iraq's new, future oil production -- a significant win for the U.S. economy. The U.S. oil sector could profit further as the bid winners begin hiring oil service firms to support oil field activities and other companies pursue downstream opportunities like refining.

¶4. (U) Impact on production: As reftel notes, the December 11-12 bid round awarded seven of ten oil field groups on offer, promising an increase in production of 4.75 million barrels per day. This is nearly twice current Iraqi production, and is nearly as large as the 4.9 million barrels per day awarded during and following the first bid round. To put this in global perspective, the cumulative 9 million barrels per day of incremental production would increase worldwide oil supply by over 10 percent.

¶5. (U) Economic benefits to Iraq: Since the GOI derives approximately 90 percent of its revenues from oil exports, the potential transformative impact of these awards on Iraq's finances is difficult to overstate. Development of the oil sector is also expected to generate tens or hundreds of thousands of direct and indirect jobs for Iraqis, not only in the oil sector but also in construction, technology, services, finance, management, and the many other sectors that support such growth.

¶6. (C) Impact on OPEC: Iraq does not currently have an OPEC oil production quota. When Iraq is once again subject to a quota, it is likely, based on reserves, that the quota could be as high as 4 million barrels per day. If/when Iraq dramatically increases oil production, it could quickly exceed any OPEC-imposed production quota by several million barrels per day (equivalent to perhaps as much as 20 percent of OPEC's total daily production). This will create significant tensions between Iraq and OPEC members, particularly its neighbors (and political adversaries) Iran and Saudi Arabia. If Iraq accepts OPEC production limits, it

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will need to slow its own oil sector growth, negatively impacting investors and slowing economic growth. If the GOI refuses to accept production limits, it could pose a threat to the efficacy and cohesion of the OPEC cartel.

¶7. (C) Impact on Shia/Sunni relations: The job creation and spin-off benefits of economic development should provide significant benefits to the citizens of the southern province of Basrah. However, if developments in other countries offer a guide, Basrah residents, living near the source of much of Iraq's wealth, could demand a greater share of Iraq's revenues and development spending. Unless country-wide revenue sharing is carefully managed, rapid economic development in the Shi'a south could exacerbate feelings of alienation among Iraq's Sunni community. Convincing the Iraqi on the street that he/she too is a beneficiary of this oil boom may require enhanced focus on good governance, transparency, social outreach, and effective, local-level development initiatives by Baghdad.

¶8. (C) Impact on Arab/Kurd relations: Tensions between Baghdad and Erbil over oil contracts remain high, and the recent bid round's success is likely to further entrench and embolden MOO resistance to accommodating the Kurdistan Regional Government (KRG) on this issue. The notable transparency of the two recent MOO-hosted bid rounds also gives Baghdad enhanced moral authority to insist that Erbil make public its oil contracts and explain how and under what terms the contracts were awarded. Meanwhile, Erbil will likely look to impede progress on the GOI's oil contracts as a means of putting political pressure on Baghdad to reach a deal on other issues of importance to Erbil.

¶9. (U) Impact on Investment Climate: The oil bid round process set a new standard for competitiveness, openness, and transparency in GOI contracting. With successful follow through, this process could become a model for broader investment in other sectors of the economy. If oil sector investors are successful in their projects, not only will the resulting revenue growth spur broader economic growth, but their success as investors could encourage broader investment in other areas.

HILL